BILL # SCR 1020

TITLE: tax exemption; business personal property

SPONSOR: Verschoor

STATUS: Senate Engrossed

REQUESTED BY: House

PREPARED BY: Hans Olofsson/Steve Schimpp

FISCAL ANALYSIS

Description

Subject to voter approval, this concurrent resolution expands the agricultural, business, and trade personal property tax exemption from the first $50,000 of the property's full cash value to the entire value of such property. The full exemption would not apply to personal property valued by the Department of Revenue (often referred to as centrally valued property).

Estimated Impact

By lowering property tax collections, this constitutional amendment is expected to increase General Fund expenditures for K-12 Basic State Aid by an estimated $93 million in FY 2006.

This fiscal impact would be mitigated by the state's Truth in Taxation (TNT) provisions. Under TNT, school tax rates are automatically adjusted annually to offset the change in the valuation of existing property. In the absence of SCR 1020, the normal growth in property values would have resulted in a reduction in school tax rates, which would have had a General Fund cost. SCR 1020 will instead reduce net assessed property value and cause an increase in school tax rates under the state's TNT provisions. As a result, there will be a General Fund savings of $64 million for TNT in comparison to the projected cost that would have incurred without SCR 1020.

In summary, SCR 1020 will increase direct General Fund expenditures by $93 million. SCR 1020, however, will cause the state's TNT provisions to cost $64 million less than under current law. If the TNT impact is included, SCR 1020's net General Fund cost would be $29 million.

Table 1 provides a summary of state and local impacts under SCR 1020. In addition to the net $29 million General Fund impact described above, Table 1 shows that SCR 1020 would shift approximately $214 million in total (school, non-school, primary and secondary) taxes from business personal property to other classes of property. This total would include an estimated $79 million to business *real* (rather than personal) property, $103 million to homeowners and $32 million to all other classes or property. The net business tax burden would decline by $164 million. These estimates assume that school districts, community colleges, cities and towns, and all other taxing jurisdictions would increase their tax rates proportionately in order to offset the smaller tax base that would exist under SCR 1020.

Analysis

To estimate the impact of SCR 1020 on the General Fund, we used tax year 2004 net assessed valuation (NAV) data provided by the state's 15 counties. If the proposed exemption were effective in tax year 2004 (or FY 2005 for state budgetary purposes), statewide NAV would decline by $(2.2) billion. Using the FY 2005 qualifying tax rate (QTR) of $3.79 per $100 NAV for unified school districts (or 50% of this rate for elementary and high school districts) and the county equalization tax rate (CETR) of $0.46 per $100 NAV for all school districts, we estimate that a NAV reduction of $(2.2) billion would increase the state share of K-12 funding by $92.8 million. Under the K-12 funding formula, whenever the local tax base is reduced, the state share of total funding increases.

Without SCR 1020, existing property value is projected to increase by 3.4%. SCR 1020 would cause existing values to decline by (1.8)% rather than increase by 3.4%. The change in existing property values triggers the state's TNT provisions. As a result, SCR 1020 would cause tax rates to increase by 1.8% instead of decreasing by (3.4)%, as under current law. This

Analysis (Cont'd)

would cause the QTR to be approximately 20¢ higher under the proposal than under current law. We estimate that such a rate increase would generate an additional $76.7 million in school district tax levies, compared to current law. As a result, the state's expected Basic State Aid General Fund cost would be $76.7 million less than expected.

The higher QTR, however, would also increase the General Fund cost for the Homeowner's Rebate. Under Arizona statutes, the state pays 35% of homeowners' primary property school district tax levies. We estimate that the TNT provisions will increase the state's cost for the rebate program by $13 million. Class 3 (i.e., owner-occupied residential) property would comprise about 48% of total NAV for all property classes under SCR 1020. In the absence of the Homeowners' Rebate, about 48% of the increased tax levy of $76.7 million, or $36.8 million, would be paid by Class 3 homeowners. However, under the rebate program, 35% or $12.9 million of this amount would be borne by the state General Fund instead.

In summary, the savings of $76.7 million to the expected TNT cost in FY 2006 would be offset by a $12.9 million cost increase for the Homeowners' Rebate. This equates to a net General Fund savings in the cost of TNT of $63.8 million. When adjusting for TNT, the direct impact of $92.8 million in K-12 funding costs would be offset by TNT savings of $63.8 million, for an overall General Fund impact of $29 million under SCR 1020.

SCR 1020 also could increase "1% cap" costs, but we assume based on past patterns that this increase would be roughly offset by the savings from the $500 per home limit on Homeowners' Rebate funding, which is not otherwise deducted from our estimates.

Local Impact

There are three main components to the tax impact – school formula primary taxes, other primary taxes and secondary taxes. The school formula primary tax effect is described above. The potential impact to other local governments depends on whether or not they adjust their tax rates to offset the reduction in the tax base.

If tax rates were not adjusted, local taxing jurisdictions would incur an estimated revenue loss of $74 million in *primary* taxes not related to the K-12 funding formula and $76 million in school and non-school *secondary* taxes *(see Table 1).* Primary and secondary taxes are levied by taxing jurisdictions such as school districts, community college districts, cities, towns and counties.

As shown in Table 1, if local taxing jurisdictions want to be "held harmless" from the impact of a reduced property tax base, they would have to raise both their primary and secondary tax rates by 5%. The increased tax rates would be shared by all classes of property other than business personal property and would result in a $74 million *primary* tax shift and $76 million *secondary* tax shift. Businesses *real* and centrally valued personal property would pay $27 million of the $74 million *primary* tax shift and $28 million of the $76 million *secondary* tax shift because of the higher "hold harmless" tax rates. This would leave $47 million in *primary* taxes and $48 million in *secondary* taxes to be shifted from businesses to all other classes of property. The $47 million net *primary* tax shift to non-business property would raise residential property taxes by $36 million and raise taxes on all remaining classes of property by $11 million. The net $48 million shift in *secondary* taxes would raise residential property taxes by $36 million and raise taxes on all remaining classes of property by $12 million.

Table 1 **Estimated Tax Impact on Various Types of Property (in millions)**

Type of Property	Primary Taxes – School Formula	Primary Taxes – Other	Secondary Taxes	TOTAL
Agricultural, Trade and Business Personal Property	$(93)	$(74)	$(76)	$(243)
Business Real Property	24	27	28	79
Residential	31	36	36	103
All Other	9	11	12	32
General Fund	29	0 1/	0	29
Net Collections	0	0	0	0
Net Business 2/	(69)	(47)	(48)	(164)

1/ In "1% cap" districts, all primary tax increases (school and non-school) would be paid by the state. For simplicity, those estimated costs are all included in the "Primary Taxes – Schools" column.
2/ Business Real Property would pay higher tax rates under the SCR 1020, which would partially offset the elimination of taxes on Business Personal Property.